Supreme Court, U.S.
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No.

In the

Supreme Court of the United States

COTSWOLD TRADING COMPANY, LTD.,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

In light of Congress' stated goal of avoiding interference with valid state-law property interests of "bona fide purchasers for value", should federal criminal forfeiture laws be construed to undermine those interests by imposing new due diligence duties and legal burdens on mortgagors and purchasers of real property that substantially exceed the burdens and duties imposed by existing state and federal law?

PARTIES TO THE PROCEEDINGS BELOW

The appellant was United States of America and the respondent was Cotswold Trading Company, Ltd.

CORPORATE DISCLOSURE STATEMENT PURSUANT TO SUPREME COURT RULE 29.6

Cotswold Trading Company, Ltd. ("Cotswold") has no parent corporation, and no publicly held company owns 10% or more of Cotswold's stock. There has been no change in this regard since Cotswold filed its disclosure statement, on or about September 12, 2003, before the Seventh Circuit Court of Appeals pursuant to Circuit Rule 26.1.

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OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, A7-A13) is reported at 362 F.3d 413. The court of appeals reversed the district court's award of summary judgment for petitioner Cotswold and entered judgment for respondent United States as a matter of law. The decision and order of the district court granting petitioner Cotswold's motion for summary judgment (App., *infra*, A1-A5), is reported in Westlaw at 2002 WL 31526558.

JURISDICTION

The judgment of the court of appeals was entered on March 25, 2004. A petition for rehearing and rehearing *en banc* was denied on June 7, 2002 (App., *infra*, A15). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 413 of the Comprehensive Drug Abuse Prevention and Control Act of 1970, 21 U.S.C. § 853, is set forth in an appendix (App., *infra*, A17-A28).

INTRODUCTION

This case tests the federal courts' willingness to enforce a Congressional directive to protect from forfeiture interests in real property that are recognized as valid under state law. The district court below was willing to do so; the court of appeals was not. The creditor here had a valid mortgage under Wisconsin law and was unaware, at the time it received the mortgage, that the debtor was under investigation for fraud. Background checks revealed no negative information about the debtor. A title report on the property revealed no liens or encumbrances. The mortgagor duly recorded its security interest with the appropriate county clerk on the day the mortgage was conveyed. More than two months later, the debtor was indicted and the government filed a *lis pendens* against the property.

The district court applied state law in affirming the validity the mortgage; the court of appeals refused to follow that lead and instead invented a kind of federal common law that contravenes the statutory law of Wisconsin and at least 42 other jurisdictions. Congress sought to ensure that litigation of property rights in ancillary proceedings would yield the same result as proceedings in state court. The court of appeals' decision destroys this symmetry. Worse, in unsettling the rights of secured creditors, the decision disembowels the bona fide purchaser for value doctrine by compelling creditors to exhaustively investigate a debtor's finances before accepting a mortgage to secure an antecedent debt. Further, by asserting that the government should have filed an involuntary petition against the criminal defendant as a "superior" means of marshaling and distributing her assets, the court of appeals not only misapplied bankruptcy law but also blatantly rejected the bi-level claims resolution system specifically devised by Congress for criminal forfeiture

cases. The resulting 'common-law forfeiture' contravenes this Court's longstanding principle of strictly construing forfeiture statutes *against* the government, not in its favor.

STATEMENT OF THE CASE

In the spring of 1999, at the height of the stock market bubble, Cotswold, an investment company owned by Hanif Mussani, an American businessman, invested a total of $1.1 million with defendant Linda Frykholm. Frykholm came highly recommended by several of Mussani's business associates, who shared with him the fruits of their prior due diligence inquiries into Frykholm and her business. Before investing the bulk of his money, Mussani asked one of his associates, Powell Woods, to make further inquiries into Frykholm, including requests for information to numerous Illinois state agencies, including the Illinois Securities Department. None of these avenues of investigation revealed anything amiss.

Frykholm was, by all accounts, an extraordinarily persuasive salesperson. She convinced dozens of people that she had the connections to provide the small investor with a rare opportunity to participate in the unregulated, high-yield, prime bank "international debentures" markets, by aggregating more modest contributions to capitalize on the rarified market access usually reserved to 'power investors'. Little did Mussani know that he had stumbled into the tail end of a $15 million Ponzi scheme.

Under the terms of three "Commitment Contracts" entered into by Frykholm and Cotswold, these were no ordinary investments, but in fact legally binding, fully enforceable debt obligations "guaranteeing" specific payments by a date certain. In the late summer of 1999, after these payments

had been repeatedly delayed, Mussani asked Cotswold's corporate counsel to take more aggressive collection efforts, which included faxing three letters to Frykholm containing generalized threats of legal action if payment was not received promptly.[1] Although he still believed that Frykholm truly intended to repay her obligations to Cotswold, Mussani was growing increasingly concerned. He had Woods hire a private investigator to check more deeply into Frykholm's background, and Mussani personally interviewed numerous additional prior investors. Other than a five-year-old civil judgment, neither the detective's report nor the interviews revealed any significant problems.

Cotswold's collection efforts appeared to bear fruit in the fall of 1999, when Frykholm agreed to make a $200,000 payment on the first commitment contract. Frykholm's two checks, however, were returned for insufficient funds. In an effort to placate her creditor, Frykholm offered Cotswold a mortgage on a valuable lakefront property she claimed to own. Understandably skeptical at this point, Mussani obtained a title report on the property that substantially increased his confidence level. It showed that Frykholm was the record owner of a $2.2 million house and property on Lake Geneva in Walworth County, Wisconsin, that was unencumbered by any liens or judgments. The clear title assured Mussani that Cotswold's mortgage would be a primary lien of substantial value, and also supported Frykholm's assertion that the civil judgment against her had been 'taken care of', thus erasing the question mark raised in the report of the private detective.

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[1]One letter, sent without Mussani's prior approval, was more specific, threatening the filing of a criminal complaint with the U.S. Attorney's office. When Mussani learned of the letter, he requested that his attorney immediately retract the threat and send a replacement letter with the offending language excised. The new letter was faxed the same day, within hours of the original letter.

On November 19, 1999, Cotswold entered into a settlement agreement with Frykholm, unaware of an ongoing FBI investigation into Frykholm which involved two field offices, federal and state investigators in no fewer than five states, multiple grand jury subpoenas and international treaty access to Swiss account records. In exchange for a $2.2 million promissory note and the mortgage on the Lake Geneva property, Cotswold agreed to extend Frykholm's repayment period by another 100 days and to halve Frykholm's debt obligation if she paid it within the extension period. Cotswold also executed various documents evidencing its consideration for the settlement, including a Conditional Release, an Extinguishment of Claims and a Covenant Not to Sue. Cotswold duly recorded its mortgage with the Walworth County Clerk on the same day the agreement was executed: November 19, 1999. That mortgage was the first lien filed against the property since it had been purchased by Frykholm.

The federal government did not go public with its investigation of Frykholm until it indicted her on January 18, 2000, and did not file a *lis pendens* against the Lake Geneva property until January 24, 2000, more than two months after Cotswold recorded its mortgage. Frykholm subsequently defaulted on the Note, triggering Cotswold's right to enforce the mortgage.[2]

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[2]To preserve its rights, before the commencement of the ancillary proceedings that resulted in the filing of this Petition, Cotswold filed its own *lis pendens* on the property and brought suit on the note and mortgage in Walworth County Circuit Court on March 15, 2000. The government was named as an additional defendant. Later that year, Cotswold was awarded a money judgment on the note and a judgment of foreclosure on the property. Cotswold then purchased the property at a judicial foreclosure sale in October, and the purchase was confirmed by Circuit Court Order on November 27, 2000. Since that time, Cotswold has been solely responsible for the upkeep of the property and, with the government's knowledge, has held itself out to the world as the property's title owner and maintained and improved the property at its own expense.

In January 2001, District Judge Philip G. Reinhard of the Northern District of Illinois, Western Division (Rockford), sentenced Frykholm to a term of 144 months on her plea to wire fraud and money laundering and entered a judgment and sentencing order forfeiting her interest in certain properties, including the Lake Geneva property. The court's Preliminary Order of Forfeiture also required Frykholm to pay restitution to her fraud victims in the amount of $10,740,791. Frykholm's sentence was affirmed on appeal. *See United States v. Frykholm*, 267 F.3d 604 (7th Cir. 2001).

Unable to persuade the government to adhere to its own procedures set forth in the Justice Department's "Expedited Forfeiture Settlement Policy for Mortgage Holders",[3] Cotswold was compelled to commence an ancillary proceeding pursuant to 21 U.S.C. § 853(n)(6)(B), which exempts from forfeiture the property interest of a claimant who is "a bona fide purchaser for value . . . reasonably without cause to believe that the property was subject to forfeiture . . .." Ancillary claims are determined according to state law, although federal forfeiture law determines whether that interest must be forfeited. *United States v. Lester*, 85 F.3d 1409 (9th Cir. 1996).

Extensive discovery established several critical and undisputed facts: (1) Cotswold did not know about Frykholm's fraudulent scheme prior to receiving the mortgage; (2) to the contrary, Cotswold was an innocent victim of that scheme; (3) Cotswold was unaware of the federal investigation into Frykholm or the government's claim to the Lake Geneva property until two months after Cotswold recorded its mortgage; and (4) none of Cotswold's inquiries into the property

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[3]This portion of the manual is reprinted in 2 Kessler, *Civil and Criminal Forfeiture: Federal and State Practice*, at pages App. F-1 to F-10 (West Group 1993 & Supp. 2004).

or Frykholm herself revealed that her assets in general, or the Lake Geneva property in particular, were the fruits of her scheme to defraud.[4]

At the close of discovery, Cotswold moved for summary judgment, demonstrating that, as a matter of Wisconsin law, it was a bona fide purchaser for value reasonably without cause to believe at the time it received the mortgage that the Lake Geneva property was subject to forfeiture. As a party to an arms-length transaction "acting in [its] own best interests," Cotswold was a "bona fide purchaser" of the mortgage. *Pelfresne v. Village of Williams Bay*, 965 F.2d 538 (7th Cir.), *cert. denied*, 506 U.S. 985 (1992).[5] By acquiring rights in the property as security for a pre-existing debt, Cotswold gave "value" for the mortgage. Wis. Stat. § 242.03(1) ("Value is given for a transfer or an obligation if, in exchange for the transfer or obligation, property is transferred or an antecedent debt is secured or satisfied"). Because there were no recorded documents or other public records filed with the Walworth County Clerk by the government or anyone else to indicate a prior adverse claim, Cotswold had no actual or constructive notice that the property was subject to forfeiture.

Opposing the motion, the government focused on the "reasonably without cause" language of the statute, contending that, as the District Court phrased it, there were "warning flags" that "would have put a reasonably prudent person on duty of inquiry, which, if prosecuted with ordinary diligence, would have led to actual notice of Frykholm's fraud and,

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[4]Cotswold produced hundreds of documents. Witnesses included Mussani, Cotswold's corporate attorney William Fearnow, FBI Special Investigator John Dalide, and Frykholm herself, who was deposed from prison.

[5]A creditor's bona fide status is unaffected by the fact that his mortgage was obtained through assertive collection activities, *Cremer v. Banking Comm'n*, 224 Wis. 174, 272 N.W. 40 (1937), or that debtor may have conveyed it with the intent of defrauding other creditors. *Bleiler v. Moore*, 94 Wis. 385, 69 N.W. 164 (1896).

ultimately, the government's interest" in the property.[6] A-2. According to the government, the diligent pursuit of these leads would have led a reasonable purchaser to discover Frykholm's five-year-old conviction for securities fraud, local press coverage from 1994 of the criminal and civil proceedings against her and a 1999 Illinois Order of Prohibition barring Frykholm from selling securities in the state. Notably, however, the government did not claim that Cotswold actually knew these additional facts or that this information was in the detective report, the title report or in any other document or report that Cotswold actually saw or to which it had access.

Drawing "all reasonable inferences in the government's favor", the district court concluded that "the government expects too much of what a 'cursory inquiry', let alone a reasonably diligent one, would produce", particularly in light of the clear title report and Cotswold's recording of the mortgage "two months before January 2000, when Frykholm was indicted and the government filed its *lis pendens* notice on the property". There was "simply nothing" in the property records "that would have given Cotswold cause to think the property might be subject to forfeiture by the government." A-3 to A-4.

The court found that it was "perhaps arguable" that Cotswold had a duty to inquire into Frykholm herself. Even assuming such a duty, however, the court could "not see how such a further inquiry, done in a reasonably diligent manner by a private company like Cotswold (as opposed to a full blown criminal investigation by the government), could have uncovered enough information such that Cotswold would

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[6]These warning flags included the nature of the investments, Cotswold's difficulty in collecting, Frykholm's use of a box at "Mailboxes Etc." for her business mail, the absence of a lien or mortgage on the Lake Geneva property, and the three Cotswold collection letters. *See* A-2 to A-3.

have reasonable cause to believe" that the property was purchased with the proceeds of her current scheme to defraud. A-3. There was no evidence that Cotswold had actual knowledge of the scheme or that "someone tipped Cotswold off about the FBI investigation". Cotswold's collection letters showed that "Cotswold may have believed Frykholm was cheating *it* [but] there [was] nothing to show it knew she was at the same time engaging in a much more far ranging scheme to defraud *and* had used the proceeds of that scheme" to purchase the property. Although "a reasonably diligent background check into Frykholm may have uncovered a somewhat sketchy past that might have given pause to a prudent investor contemplating an investment with her . . . it is simply unrealistic to expect Cotswold to have discovered that the 1982 Walworth Property in particular was bought with the proceeds of Frykholm's scheme to defraud and, therefore, was subject to forfeiture." A-4 to A-5.

The government appealed to the court of appeals for the Seventh Circuit, which reversed the district court's award of summary judgment to Cotswold, entered judgment for the government and dismissed Cotswold's ancillary petition without a hearing.

The first two-thirds of the court of appeals' opinion — addressing what Cotswold allegedly knew and what the court believed it should have known — seemed to presage a remand for trial on the litigated issue of whether Cotswold had "reasonable cause to believe that the property was subject to forfeiture". In a surprise ending, however, the court of appeals reversed on the law and entered judgment for the non-movant government on an issue never raised by any party below or on appeal — fraudulent transfer. The court euphemistically opined that "[n]either side paid much attention to the effect of the fraudulent conveyance . . .." 364 F.3d at 417; A-12. In fact, the phrases "fraudulent conveyance", "fraudulent transfer" or the like never appeared in any paper

filed with any court in this case. This is not merely a procedural matter. Under Wisconsin law, under the law of 42 states, plus the District of Columbia, that have adopted some version of the Uniform Fraudulent Transfer Act ("UFTA"), and under the federal Bankruptcy Code, a claim of fraudulent transfer must be raised, pleaded and proven by the party seeking to invalidate the transaction. *See In re Loyal Cheese Co.*, 969 F.2d 515 (7th Cir. 1992) (creditor under both federal and Wisconsin law has burden of proving fraudulent transfer by clear and convincing evidence).

By holding that the issue of fraudulent conveyance had to be addressed even if not raised by a creditor or the trustee, the court effectively upended Wisconsin's burden of proof on this issue and forced Cotswold, the transferee, to demonstrate that it did *not* receive a fraudulent transfer.[7] Instead, the court *sua sponte* raised and decided the issue at the same time, denying Cotswold the opportunity to be heard, even though Cotswold specifically requested such an opportunity in its petition for rehearing.

The court of appeals found that Cotswold was not a bona fide purchaser for value because (1) Frykholm was insolvent when she conveyed the mortgage to Cotswold, and (2) Frykholm "did not receive reasonably equivalent value for the exchange; indeed she received no new value at all." 362 F.3d at 417; A-12. Under both federal and state law, however, unless a transferee is an "insider" of the debtor, "new value" is not required to satisfy the statutory standard of "reasonably equivalent value". Wis. Stat. § 242.08(6) (transfer to "insider" is not voidable "to the extent that the insider gave *new value* to or for the benefit of the debtor after the transfer was made") (emphasis added); *see* 11 U.S.C.

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[7]Of course, Cotswold was never given a chance to show that there was no fraudulent transfer, which could have been established by quoting a single statutory phrase. *See* Wis Stat. § 242.03(1).

§ 101(31); Wis. Stat. § 242.01(7) (definitions of "insider"). Here, there was no claim that the mortgage transaction was not arms-length; to the contrary, Cotswold has been classified by the government itself as one of Frykholm's victims.

The court of appeals' conclusion that securing an antecedent debt is insufficient to confer bona fide purchaser for value status was belied earlier in the court's decision itself, where the court noted that "[t]he United States questions whether the holder of a security interest given in exchange for an antecedent debt can be a bona fide purchaser for value but has not pursued the point — sensibly so." 362 F.3d at 416; A-10 (citations omitted).

Once the 'new value' red herring is discarded, it becomes clear that, under both federal and state law, the transfer of the mortgage to Cotswold to secure a pre-existing debt was intrinsically a transfer for a reasonably equivalent value.[8] By finding a *lack* of reasonably equivalent value as a matter of law, without briefing or a hearing, for the first time on

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[8] *In re Anand*, 210 B.R. 456, 459 (Bankr. N.D. Ill. 1997) ("as a matter of law collateralizing an antecedent debt cannot constitute less than reasonably equivalent value regardless of the value of the collateral . . . because the excess over the debt is not lost to the debtor or other creditors"), *aff'd*, *Anand v. National Republic Bank of Chicago*, 239 B.R. 511 (N.D. Ill. 1999); *see* UFTA §§ 3-4 comment, 7A U.L.A. 651, 654 (1984) ("Under this Act . . . a transfer for security is ordinarily for a reasonably equivalent value"); *Sedwick v. Gwinn*, 873 P.2d 528, 533-34 (Wash. App. 1994). Moreover, as the district court noted in affirming the bankruptcy court in *Anand*, a finding of reasonably equivalent value is bolstered by the same kinds of additional factors that were present in the Cotswold-Frykholm transaction: "forbearance, a revised maturity date, and a waiver of the principal payment, [which] must all be counted as value received." 239 B.R. at 519 (citing *In re Ward*, 36 B.R. 794, 799 (Bankr. S.D. 1984)).

appeal, the court of appeals also contravened a substantial body of law holding that reasonably equivalent value is ordinarily a question of fact.[9]

The court of appeals compounded its error in meting out Cotswold's punishment for the alleged fraudulent transfer, holding that the conveyance of the mortgage "transfer[red] no rights [and] prevent[ed] the transferee from achieving the status of a bona fide purchaser for value." 362 F.3d at 417; A-12. As a result, the court invalidated the mortgagor's entire security interest, even the portion securing its out-of-pocket loss, and ordered the mortgagor to "stand in line with the rest" to receive a percentage of the $1.1 million it originally gave Frykholm. 362 F.3d at 417; A-13. In fact, where a transfer is avoided by a trustee or state law creditor on constructive fraudulent transfer grounds, the "good faith transferee" is entitled to a lien on the property recovered equal to the amount of the actual consideration paid, plus any amounts expended to maintain or improve the property. *See* 11 U.S.C. §§ 548(c), 550; Wis. Stat. § 242.08(4); Collier on Bankruptcy, ¶ 548.07[2][a] and cases cited therein. Thus, even if the mortgage were deemed to be a fraudulent transfer, Cotswold would retain its secured status for the full amount

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[9]*See, e.g., In re Image Worldwide, Ltd.*, 139 F.3d 574, 576 & n.2 (7th Cir. 2000) ("undisputedly a question of fact"); *accord Mann v. Hanil Bank*, 920 F. Supp. 944 (E.D. Wis. 1996) (applying Wisconsin law). Indeed, the court's probing of the adequacy of Cotswold's consideration for the transfer, absent a claim of fraud or mistake, is itself a contravention of prior decisions. *See Scholes v. Lehmann*, 56 F.3d 750, 756 (7th Cir.) (Posner, J.) ("Unless fraud or mistake is alleged, ordinarily a court will not even permit inquiry into the adequacy of the consideration for a promise or transfer"), *cert. denied sub nom. African Enterprise, Inc. v. Scholes*, 516 U.S. 1028 (1995). Moreover, the burden of proving lack of reasonably equivalent value is on the creditor or the bankruptcy trustee. *Barber v. Golden Seed Co.*, 129 F.3d 382, 387 (7th Cir. 1987). Here, such a claim was not even raised by a party, let alone proven. There is no precedent for a *trial court* raising and deciding the issue *sua sponte*, let alone a court of appeals.

of the $1.1 million debt and would be entitled to recoup all monies it spent maintaining and improving the Lake Geneva property, less any income therefrom, as well as the interest and fees to which it is entitled under the duly recorded note and mortgage.

Although the court of appeals did not resolve the appeal based on the issue that was before it — whether Cotswold was reasonably without cause to believe, at the time it received the mortgage on the Lake Geneva property, that the property was subject to forfeiture — the court nevertheless 'poisoned the record' by making its own unsupported findings of fact, ignoring undisputed probative facts and twisting the law of ancillary claims under 21 U.S.C. § 853(n)(6)(B). The court of appeals disregarded the true issue in dispute — the validity of Cotswold's *mortgage*. While the prudence of entrusting $1.1 million to Frykholm's safekeeping may be open to question, once that transaction was completed, it became, undisputedly, a *legitimate debt*, and therefore sufficient to support the subsequently conveyed mortgage. Yet, the court of appeals' decision is almost completely preoccupied with the nature and financial scope of Frykholm's Ponzi scheme and the return to defrauded investors. When it mentions the mortgage at all, the court treats it as little more than an impediment to the noble goal of forfeiting "all assets traceable to the scam's proceeds [which] the United States plans to use to make restitution to victims . . .." 362 F.3d at 415; A-8.

The fact is, however, that the supposed obviously too-good-to-be-true nature of Frykholm's investments — which were no more profitable than many other contemporaneous, *regulated* investments — is related to the validity of the mortgage only to the extent it can be found to have given Cotswold reasonable cause to believe, at the time it received the mortgage, that the Lake Geneva property was subject

to forfeiture. Indeed, the district court acknowledged the importance of distinguishing between the Commitment Contracts and the mortgage, noting the logical leap necessary to get from Frykholm's failure to repay her obligation to Cotswold to deducing that she had purchased the Lake Geneva property with the proceeds of a multi-year, $15 million Ponzi scheme.

Analytically isolating the mortgage makes clear that the applicable state law is Wisconsin real property law and the law of secured transactions, not contract law, restitution, bankruptcy law or something else. The legal context for the evaluation of Cotswold's ancillary claim is completely different than for that of an unsecured creditor who has a general claim against Frykholm's assets.[10] Equally important, the universe of constructive notice is far more restrictive for secured creditors. Mortgage holders are entitled to rely on title reports; unsecured creditors are not. Mortgage holders are entitled to rely on documents filed in the office of the county clerk; unsecured creditors are not.[11]

This body of law, and the accompanying undisputed facts, are absent from the court of appeals' decision. There is no mention of the clear title report, or the fact that Cotswold's recording of the mortgage predated the government's

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[10]Indeed, unsecured creditors are not even considered by most courts to have standing to assert an ancillary claim under 21 U.S.C. § 853(n)(6)(B). *See, e.g., United States v. BCCI Holdings (Luxembourg), S.A.*, 46 F.3d 1185, 1191-92 (D.C. Cir.), *cert. denied sub nom., Chawla v. United States,* 515 U.S. 1160 (1995). Unsecured claimants are relegated by the statute to non-judicial avenues for recovery. *Id.*, 46 F.3d at 1192 & n.2 ("parties without an interest in specific property [must] seek relief from the Attorney General, not the court adjudging the forfeiture").

[11]*See, e.g.*, Wis. Stat. § 706.08(1)(a) ("every conveyance . . . which is not recorded [is] void as against any subsequent purchaser in good faith and for a valuable consideration"); *Kordecki v. Rizzo*, 106 Wis. 2d 713, 719, 317 N.W.2d 479, 482 (1982) (statute is intended "to render record title authoritative to protect a purchaser who relies on the record and is a purchaser in good faith and for a valuable consideration").

indictment of Frykholm and filing of the *lis pendens* by more than two months. There is no mention of the detailed report of Cotswold's private investigator or Cotswold's inquiries with Illinois state agencies regarding Frykholm's background. There is no mention of the fact that the government's investigation was not only kept from Cotswold, but that its investigators were well aware of the November 19, 1999 settlement that resulted in the conveyance of the mortgage and sat by and allowed it to be consummated. In fact, the government's secret surveillance of Cotswold's transaction was *part* of its investigation.

Instead, the court of appeals invented its own facts, concluding, for example, that "routine inquiry would have disclosed" the stop order issued by the Illinois Securities Department. In fact, the government introduced no proof to support such an assertion and it is undisputed that neither Cotswold's *direct inquiry* nor the detective's report uncovered it. Although the court stops short of claiming that Cotswold should have discovered the "1994 conviction for theft and forgery", the implication is clear. Ignoring the repeated positive reports that Cotswold received about Frykholm from many different credible and legitimate sources, the court implies that the *only* thing Cotswold had to go on was the delighted endorsements of Frykholm investors who had been paid in the first wave of the Ponzi scheme.

The court of appeals' conclusion that "[t]he state of Cotswold's knowledge is the subject of a material dispute" is incorrect. There is no dispute about what Cotswold knew and what it did not know. The only disputed issue is legal, not factual: what constitutes a reasonable inquiry by a party who acquires a mortgage on real property to secure a pre-existing debt?[12] Similarly, there is no dispute about the *existence* of

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[12]Where the only matter in dispute is the application of legal principles to undisputed facts, resolution by summary judgment is appropriate. *See, e.g., Williams v. McAllister Bros., Inc.*, 534 F.2d 19, 21 (2d Cir. 1964)

the government's so-called "warning signs". The only dispute is whether a "reasonable inquiry", triggered by those signs, would have revealed the next level of information that would have stopped Cotswold in its tracks: the five-year-old criminal conviction, the Illinois securities prohibition and the local news coverage from 1994 of the civil and criminal proceedings.[13] Thus, resolution by summary judgment was appropriate.

Even the court of appeals acknowledged that "[i]t is hard to go . . . in the direction of an investigation requirement . . . and reading § 853(n)(6)(B) to require investigation as a condition of being an innocent purchaser would all but vitiate the statute's goal of protecting persons who meet state-law definitions of bona fide purchasers for value." 362 F.3d at 416; A-11 (citing *United States v. Lavin*, 942 F.2d 177, 186 (3d Cir. 1991)). The court's conclusion that Cotswold simply

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(affirming summary judgment after applying legal principles to undisputed facts"); *Daniel v. United States Internal Revenue Serv.*, 227 B.R. 675, 683 (N.D. Ind. 1998) ("A summary judgment is proper where the issues of the case are concerned exclusively with the application of legal principles to undisputed facts") (citing, *inter alia*, *Golden v. Kentile Floors*, 475 F.2d 288, 291 (5th Cir. 1973)). Indeed, even the government did not contend on appeal that Cotswold's bona fide purchaser status was not properly resolved on a motion for summary judgment.

[13]Where the facts are undisputed, reasonableness becomes a question of law. *See, e.g.*, *LaFarge Corp. v. Hartford Cas. Ins. Co.*, 61 F.3d 389, 404-05 (5th Cir. 1995); *Leasing Service Corp. v. River City Constr., Inc.*, 743 F.2d 871, 878 (11th Cir. 1984); *I.C.C. v. Gould*, 629 F.2d 847 (3d Cir. 1980), *cert. denied*, 449 U.S. 1077 (1981). The government conceded that the prior conviction could only be found in the clerk of the county where it was docketed. Thus, without knowing where to look, it would never be found absent a search in every clerk's office in the region. Nor did the government claim that Cotswold had a duty to look through years of microfiche in libraries across the region in search of articles in local newspapers about Frykholm. In addition, as noted above, the government failed to adduce any proof to support its assertion that the Illinois Order of Prohibition was publicly available, or that Cotswold's efforts to ascertain this information were less than diligent.

stuck its head in the sand and ignored the obvious fact that the Lake Geneva property was purchased with fraud proceeds is, however, completely unsupported by the record. Indeed, the court could only make such a conclusion *sound* reasonable if it left out all of the information Cotswold relied upon in determining that acquiring the mortgage would be a legitimate transaction. And, indeed, that is exactly what the court did.

REASONS FOR GRANTING THE PETITION

As litigated before the district court, this case raised the important question of whether federal forfeiture law should be construed to impose additional duties of inquiry on purchasers of interests in real property beyond those imposed by state law. The district court answered that question in the negative, finding that, where there is nothing in the county records to indicate that property may be subject to forfeiture, and the buyer does not know that the seller is under criminal investigation or that the property was purchased with illegal proceeds, the buyer should be recognized as a bona fide purchaser for value reasonably without cause to believe that the property was subject to forfeiture. The facts of this case highlighted these issues more starkly than prior decisions in this area because it was undisputed that Cotswold met state law requirements for a valid mortgage and had no actual knowledge of Frykholm's fraudulent scheme. Thus, in many respects, this case is a unique test of the federal courts' willingness to apply state law even where it appears to militate against the interests of the federal government.[14]

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[14]Even the court of appeals, at oral argument, rejected the government's attempt to find analogous support in previous decisions rejecting claims under 21 U.S.C. § 853(n)(6)(B). *See United States v. Medina Cuartes*, 155 F. Supp. 2d 1338 (S.D. Fla. 2001) (court refused to enforce claimant's unconsummated purchase of U.S. dollars on Colombian black market after sellers were arrested for narcotics trafficking); *United States v. McCorkle*, 143 F. Supp. 2d 1311 (M.D. Fla. 2001) (claimant bank "knew [defendant] was under investigation for money laundering" when it obtained mortgage, had been subpoenaed by Attorneys General of two states regarding defendant, yet continued to do business with defendant); *United States v. BCCI Holdings (American Express)*, 961 F. Supp. 287 (D.D.C. 1997) (huge multinational corporation with inchoate claim against defendant's general assets disregarded warnings from regulators and numerous New York Times and Wall Street Journal articles detailing defendant's impending collapse).

The Petition should be granted because the court of appeals' decision conflicts with state statutes and interpretive case law in jurisdictions throughout the country. Both procedurally and substantively, the court of appeals' decision has so far departed from the accepted and usual course of the resolution of ancillary claims in federal criminal forfeiture proceedings, state real property law and federal bankruptcy law that the exercise of this Court's supervisory powers is warranted.

From a procedural perspective, the court of appeals' decision appears unprecedented in dismissing an ancillary claim without a hearing on a ground other than lack of standing. *See United States v. East Carroll Correctional Systems, Inc.*, 14 F. Supp. 2d 851, 853 (W.D. La. 1998) ("Where a party seeking relief pursuant to Section 853(n)(6) fails to allege . . . standing, the court may dismiss the petition without a hearing") (citations omitted). Indeed, a main purpose of the 1984 amendments to section 853 (and its RICO counterpart, 18 U.S.C. § 1963(*l*)), was "to provide notice and a hearing to third parties claiming an interest in the forfeited property", thereby preserving the "fundamental . . . due process [principle] that a property interest shall not be divested without some kind of hearing." *Kuhn v. Vista Disposal, Inc.*, 826 F. Supp. 218, 222 (E.D. Mich. 1993) (citations omitted).

The decision's substantive aspects are equally unprecedented. This appears to be the first reported forfeiture case to rule against a bona fide purchaser for value of a security interest in real property on the ground of constructive fraudulent conveyance. This is not surprising, because the court's version of state law does not actually exist in any jurisdiction, including Wisconsin. Indeed, the fuzziness of the court's analysis, unencumbered by submissions from the actual parties in interest, is revealed by the court's failure to specify whether the alleged fraudulent transfer was constructive or intentional and whether Cotswold was an insider or an

arms-length purchaser. *Cf. BFP v. Resolution Trust Corp.*, 511 U.S. 531, 535 (noting distinction in Bankruptcy Code between "transfers infected by actual fraud . . . [and] so-called constructively fraudulent transfers"), *reh'g denied*, 512 U.S. 1247 (1994). Given the court's naked goal of fattening the restitution fund, it was sufficient to simply declare, without more, that the mortgage transfer was fraudulent.

Because of the court of appeals' decision, the law has changed. Until now, bona fide purchaser status protected a transferee in a transaction later found to constitute a constructive fraudulent conveyance. *See, e.g., Ostashko v. Ostashko*, 2002 WL 32068357, at *27 (E.D.N.Y. Dec. 12, 2002) ("An otherwise fraudulent conveyance cannot be set aside when the transferee is a bona fide purchaser for value") (citation omitted), *aff'd sub nom. Ostashko v. Zuritta-Teks, Ltd.*, 79 Fed. Appx. 492 (2d Cir. 2003); *United States v. 92 Buena Vista Ave.*, 738 F. Supp. 854, 861 (D.N.J. 1990) (same), *aff'd in part, remanded in part on other grounds*, 937 F.2d 98 (3d Cir. 1991), *aff'd*, 507 U.S. 111 (1993). Indeed, that protection appeared to be a primary benefit of attaining bona fide purchaser for value status. Under the court of appeals' decision, a bona fide purchaser for value may no longer be protected against the voidability of a fraudulent transfer. As a result, substantial doubt has been cast on the previous certainty of commercial transactions. *See United States v. Lavin*, 942 F.2d at 186 ("The good-faith purchaser exception developed over time in order to promote finality in commercial transactions and thus to encourage purchases and to foster commerce") (citations omitted).

The negative impact of the case, however, will be substantially more far-reaching. By purporting to ground the decision on state property law and federal bankruptcy law, the court's reasoning undermines at least *three* bodies of law: federal forfeiture law, Wisconsin state law (as well as the law of the other 42 jurisdictions that have adopted the UFTA),

and federal bankruptcy law. The decision also contravenes this Court's longstanding doctrine against non-statutory forfeitures, and flies in the face of Congress' bipartite statutory scheme for resolving (1) claims to specific property deemed subject to forfeiture and (2) general claims against the defendants' forfeited assets.

Federal forfeiture law: In citing *United States v. Lavin*, a seminal case on the bona fide purchaser for value provision of section 853, and discussed at length in Cotswold's submissions below, the court of appeals clearly acknowledged the Third Circuit's conclusion that "Congress derived [this provision] essentially from hornbook commercial law". As the *Lavin* court observed, "[s]ection 853(n)(6)(B) ensures that, if indeed the defendant transfers the forfeitable property for value to a purchaser who, at the time of the purchase, is without knowledge of the government's interest in the property, the government may not later assert title superior to that of the innocent purchaser." *Lavin*, 942 F.2d at 186. Here, the court of appeals' decision appears to adhere to this reading of the statute by claiming to apply Wisconsin state law in awarding summary judgment to the government. As discussed above, however, the court did *not* apply state law. It only *purported* to do so.

In drafting section 853(n)(6)(B) to protect property interests of bona fide purchasers for value, Congress sought to ensure that a property owner who is compelled to file an ancillary proceeding in federal court will be left in no worse a position than if litigating to protect that same interest in state court. Similarly, the government should be in no *better* a position than the *defendant* had there been no forfeiture. *See United States v. Harris*, 246 F.3d 566, 576 (6th Cir. 2001) ("the government steps into the shoes of the defendant acquiring only the rights of the defendant at the time of the criminal acts, and nothing more. . . .. To hold otherwise would give the government greater rights than Defendant, and would go

against the intent of Congress in enacting § 853(n)(6)(B)"); *see also United States v. O'Dell*, 247 F.3d 655, 680 (6th Cir. 2001) (limitation on government's rights stems from *in personam* nature of criminal forfeiture).

As a result of the Seventh Circuit's decision, however, the rights of the parties to certain ancillary proceedings no longer mirror their state court counterparts. In state court, creditors seeking to void the transfer continue to bear the burden of pleading and proving that a transaction constitutes a fraudulent conveyance. Now, in federal court, the burden has shifted to the transferee to establish, as part of his affirmative burden and case-in-chief, that the transaction was *not* a fraudulent transfer. Thus, it no longer matters that there is no creditor with standing to assert a fraudulent transfer claim, nor that the statute of limitations on such a claim may have expired.[15]

There are other ways in which the litigation of property claims in state court and federal court has diverged as a result of the decision in this case. In state court, only transferees who are "insiders" of the debtor are required to give new value at the time of the transfer to avoid a finding of fraudulent conveyance. For all other transferees, the repaying or securing of an antecedent debt remains sufficient to satisfy

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[15]In this case, both are true. The government would have no standing to raise a fraudulent transfer claim under Wisconsin law and the statute of limitations on such a claim has already expired. *See* Wis. Stat. § 242.05(1) (statute protects only creditors "whose claim arose before the transfer was made"); *compare United States v. Bennett*, 2003 WL 22208286, at *2 (S.D.N.Y. Sept. 24, 2003) (government had standing to invalidate "insider" fraudulent transfer from defendant to spouse under N.Y. Debtor and Creditor Law §§ 275-76 because those statutes cover transactions that are "fraudulent as to both present and future creditors" and the government which has a judgment of forfeiture . . . is a 'future creditor' "); *see also United States v. 92 Buena Vista Ave.*, 507 U.S. 111, 129 (1993) (government's interest in forfeited property does not vest or relate back until final order of forfeiture is entered).

the statutory standard of "reasonably equivalent value." This is no longer true when those same transferees attempt to enforce their security interests in an ancillary proceeding in federal court. Now, under the court of appeals' ruling, even creditors who were *not* insiders of the debtor must give new value, or the transaction will be deemed a constructive fraudulent transfer.

The court of appeals' decision will have even further consequences nationwide. In at least 42 states and the District of Columbia, secured creditors whose interest in real property is found to have been acquired in a constructive fraudulent conveyance will still be deemed secured up to the amount of the debt that supported the secured interest and be entitled to out-of-pocket expenses and contractual rights of recovery. In ancillary proceedings in federal court, however, this same secured creditor will be stripped of his entire security interest and be relegated to the status of an unsecured creditor, where he must "stand in line with the rest."[16] Thus, the decision below undermines Congress' intention to ensure that state law property ownership is upheld in ancillary proceedings brought pursuant to 21 U.S.C. § 853(n)(6)(B).[17]

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[16]The courts have properly found that the "reasonably without cause to believe language" in the second clause of 21 U.S.C. § 853(n)(6)(B) is not intended to alter state law. In *Lavin*, the court reasoned that, rather than signaling the adoption of something other than state law, the "reasonably without cause to believe" language is merely an "[e]xtension of the good-faith purchaser exception to the forfeiture context . . .." 942 F.2d at 186. Any other result would contravene established principles of statutory construction. Subsection (B) is a single statutory sentence with a single purpose: to protect property interests recognized as valid under applicable state law. *See, e.g., United States v. Morton*, 467 U.S. 822, 828 (1984) ("We do not . . . construe statutory phrases in isolation").

[17]*Cf. United States v. Certain Real Property Located at 2525 Leroy Lane*, 910 F.2d 343, 350 (6th Cir. 1990) (government, under authority to assume a defendant's interests in property, may not by virtue of a forfeiture order alter essential characteristics of state law-based tenancy by the entireties), *cert. denied sub nom., Marks v. United States*, 499 U.S. 947 (1991).

State Property Law: The negative impact of the court of appeals' decision on Congress' goal of preserving unity of approach to property claims in state and federal court is actually a *best case* scenario. If, because of the decision, property owners are rendered worse off litigating in federal court than in state court, then it means that at least *state law* has not changed. Real property law practitioners, however, are a notoriously cautious breed. A case that negatively impacts secured creditors' rights will quickly establish a new benchmark for the applicable standard of care in such transactions.

Thus, the potential impact of the court of appeals' decision on the way state lawyers practice and, more importantly, the way their clients do business, is substantial. For more than a century, in Wisconsin and throughout the country, when challenged by other creditors, mortgages obtained by unpaid creditors who have persuaded their debtors to secure an outstanding debt have been upheld by the courts.[18] After the Seventh Circuit's decision, secured creditors will conclude that, because there is always a risk that a parcel of property will become subject to federal forfeiture, they must hence-forth do more than simply record their mortgages and extend

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[18]*See, e.g.*, 55 Am. Jur. 2d Mortgages § 308 (where "a mortgage is taken for a pre-existing debt, and the creditor at the time agrees to extend the time of payment, [such consideration] will entitle the mortgagee to protection as a purchaser for value") (citations omitted); 39 A.L.R.2d 1088, § 1[b] ("if, as consideration for a mortgage executed to secure a pre-existing indebtedness, the mortgagee extends the time for payment of, or forbears bringing suit upon, the debt, then he has given value, and is entitled to priority, as a bona fide purchaser, over prior equities of which he had no notice") (citations from *twenty-three* different jurisdictions omitted). Wisconsin is among the states where even extension of the repayment period is unnecessary to preserve bona fide purchaser status. *See Barth Brothers v. Billings*, 68 Wis. 2d 80, 85-86, 227 N.W.2d 673, 676-77 (1975).

the payment period to ensure that their property interests are absolutely protected from being invalidated as a fraudulent transfer.

As noted by the court of appeals, only two elements are necessary to establish a constructive fraudulent transfer: (1) the debtor's insolvency, and (2) a lack of reasonably equivalent value. If this decision and its requirement of "new value" in non-insider transfers is allowed to stand, a creditor who takes a mortgage to secure an antecedent debt will be unable to guarantee a judicial finding of reasonably equivalent value without taking the unpalatable step of lending the deadbeat debtor even *more* money at the time the mortgage is conveyed.

That leaves only the element of insolvency. Making absolutely sure that a debtor is not insolvent and will not be rendered insolvent by the mortgage transfer is no simple matter. A full financial audit requires diligence, money and time. More critically, imposing such a duty on mortgagors would undermine the primary purpose of the bona fide purchaser doctrine — to eliminate "the need for a purchaser to engage in exhaustive research . . . prior to consummating a sale." *Lavin*, 942 F.2d at 186; *see Johnson & Johnson Prods. v. Dal Int'l Trading Co.*, 798 F.2d 100, 104 (3d Cir. 1986) ("the purpose of the good faith purchaser doctrine . . . is to promote commerce by reducing transaction costs").

***Bankruptcy Law*:** The court of appeals appeared convinced that, had the government timely filed an involuntary bankruptcy petition against Frykholm, "everything would have been clearer . . .." 362 F.3d 417; A-12. According to the court, "[b]ankruptcy would have made it pellucid that Cotswold cannot enjoy any priority over the other victims and cannot reap a profit while Frykholm's other creditors go begging . . .." *Id.*; A-12 to A-13. The court therefore opined that, while it could no longer reclaim the profits earned by Frykholm's first wave of investors, "it is not too late to

prevent the preferential distribution of any further assets to favored investors", and thus invalidated Cotswold's security interest in the Lake Geneva property. *Id.*; A-13.

The court's construction of bankruptcy law is at best incorrect and, at worst, disingenuous. Had a bankruptcy petition been timely filed, "everything" would not have been "clearer"; everything would have been *different*. The court would not have had to contort fraudulent transfer law to accommodate the facts of this case, because the transfer of the mortgage could have been challenged as a *preference* rather than a fraudulent conveyance. Indeed, the court's use of the terms "priority" and "preferential distribution" reveals an awareness that it was not applying actual bankruptcy law. A preference can only be enforced by a trustee in bankruptcy in the context of an actual bankruptcy proceeding. Here, there was no proceeding and no trustee. Therefore, Cotswold's mortgage could not be avoided as a preference. Even if it had, Cotswold *still* would have retained a lien on the property to secure, among other things, the cost of any improvements. *See* 11 U.S.C. § 550(e)(1).

If a bankruptcy proceeding had been filed *outside* of the 90-day preference period, Cotswold's security interest would have been fully enforceable. *See* 11 U.S.C. § 550 (under the Bankruptcy Code, just as under state law, bona fide purchaser for value status insulates the transferee from the voidability of a fraudulent transfer); *In re Image Worldwide*, 139 F.3d at 577 (UFTA derived fraudulent transfer provisions from section 548 of the Bankruptcy Code, 11 U.S.C. § 548). As the court of appeals itself noted, Wis. Stat. § 242.05 and 11 U.S.C. § 548 are "parallel" provisions. 362 F.3d at 417; A-12 (citing *In re Loyal Cheese Co.*, 969 F.2d at 518-19). Thus, all of the mischief wreaked by the court of appeals' decision on state law — upending the burden of proof, requiring new

value for non-insider transfers and stripping creditors of their security interests for constructive fraudulent transfers — equally affects bankruptcy law.

The unreal, hypothetical nature of the court of appeals' decision was best exposed by none other than the plaintiff in this case — the government. After Cotswold filed its petition for rehearing, the court of appeals requested a response from the government. After spending twelve pages praising the correctness of the panel's decision, the government undid all of its prior contentions in a 29-line footnote appended to the last sentence. Insofar as the preparation of these papers was overseen by the Washington, D.C. Deputy Chief of the Justice Department's Asset Forfeiture & Money Laundering Section, one can safely assume that this footnote represents the government's official position on this issue.

In the footnote, the government expresses concern that the court of appeals' unsolicited suggestion that "the United States should have instituted an involuntary bankruptcy proceeding against Frykholm pursuant to 11 U.S.C. § 303 in order to marshal her assets and distribute them to her creditors" could undermine future forfeiture proceedings:

> The government's concern with this wording is that it may tempt claimants and/or defendants in future cases to cite it as legal authority for the proposition that the government's pursuit of forfeiture in a particular case is inappropriate because it has the option of instituting an involuntary bankruptcy proceeding.

The government not only strongly disagreed with the notion that it could ever have an "obligation" to institute bankruptcy proceedings, but also set forth substantial legal authority demonstrating that it would lack standing to do so, because it is not a "creditor" with a "claim" against the defendant within the meaning of the Bankruptcy Code. 11 U.S.C. §§ 101(5), (10). Moreover, "forfeitable assets do not

become part of the bankruptcy estate" (citing, *inter alia*, *In re Chapman*, 264 B.R. 565 (9th Cir. BAP 2001); *In re James*, 940 F.2d 46, 51 (2d Cir. 1991)).

The government then definitively put to rest the court of appeals' dreamy vision of bankruptcy law, noting that, even if the practical hurdles to such a proceeding were to magically disappear, Cotswold would probably *still* win, because, according to priority rules in the Bankruptcy Code, the *government* would not only "stand in line with the rest", but it would probably stand near *the end of the line*:

> An additional problem with an involuntary bankruptcy is that creditors outside the group of Frykholm's (or any defendant's) victims would have the right to file claims in Bankruptcy Court thus diluting the pool of funds available for restitution. Indeed, if the distribution scheme in chapter 7 is strictly applied, *the government would take in fourth priority* after all timely and tardily filed unsecured claims were paid. It also appears that a government claim for restitution would not receive any higher of a priority. (emphasis added) (citing, *inter alia*, 11 U.S.C. § 726(a)(4); *In re Seneca Oil Co.*, 906 F.2d 1445 (10th Cir. 1990)).

Given the government's devastating dismantling of the heart of the court of appeals' decision, it is clear the government's victory on the merits was the only thread that stopped it from filing a cross-petition for certiorari.

The Court of Appeals' 'Better Mousetrap': The court of appeals conceded that the filing of a bankruptcy proceeding was not the only avenue available for marshaling and distributing Frykholm's assets; rather, it was, in the court's view, "a superior way." 362 F.3d at 417; A-13. Specifically, the court opined that bankruptcy would be superior to the *actual forfeiture statute in issue*, which "allows the Attorney General to use forfeited assets for restitution . . ." *Id.* (citing 21 U.S.C.

§ 853(n)(1)). According to the court of appeals, the method Congress has specified for use in this precise situation should be disregarded because "it does not create a comprehensive means of collecting and distributing assets." *Id.* Therefore, the court prescribed something 'better'.

The government has already shown that the supposedly superior asset distribution system set forth in the Bankruptcy Code cannot be used in cases like this. Further, Cotswold has demonstrated that, even if bankruptcy were an option, it would not yield the result reached by the court of appeals. To the contrary, it would mirror the district court's judgment for Cotswold.

Having issued a decision that disregards statutes from dozens of jurisdictions, the court of appeals appears to have thrown caution to the wind and simply invented its own restitution statute. As the court acknowledged, Congress has created a specific system for the processing of claims in this area. *See, e.g., United States v. BCCI Holdings, supra*, 46 F.3d at 1192 & n.2 ("The Attorney General has the authority to dispense confiscated funds 'to protect the rights of innocent persons,' and general creditors seem precisely the type of innocent persons Congress had in mind"). What Congress did *not* have in mind was that courts would invalidate bona fide property interests of secured creditors to give the Attorney General more money to dispense to general creditors.

***Common-law Forfeitures*:** The court of appeals engaged in an extreme form of judicial activism to reach what it believed was a just result. It is well settled, however, that property cannot be forfeited absent an authorizing statute. *See, e.g., United States v. One 1976 Mercedes Benz 280S*, 618 F.2d 453, 458-59 (7th Cir. 1980) ("It is difficult to imagine how a proceeding to enforce a statutory forfeiture can resemble in any respect a suit in equity"). Forfeiture statutes are strictly construed *against* the government, particularly *in personam* criminal forfeitures, which have no

grounding in English common law. *See United States v. Alexander*, 509 U.S. 544, 563 (1993) (all forfeitures are regarded with "historic disfavor"; criminal *in personam* forfeitures, which are "novel for their punitive character as well as their unprecedented sweep", are even more disfavored); *United States v. One Ford Coach*, 307 U.S. 219, 226 (1939) ("Forfeitures . . . should be enforced only when within both letter and spirit of the law")). The court of appeals' forfeiture of Cotswold's mortgage on a non-statutory basis violated these important principles.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

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UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS

U.S.

v.

FRYKHOLM

No. 00 CR 50001-2

Nov. 13, 2002

MEMORANDUM OPINION AND ORDER

REINHARD, *J.*

On August 31, 2000, Linda Frykholm pleaded guilty in this court to wire fraud and money laundering. After Frykholm's sentencing, the court entered an amended judgment on January 24, 2001, which, among other things, forfeited Frykholm's interests in certain properties, including 1982 North Lake Shore Drive in Delevan, Walworth County, Wisconsin ("1982 Walworth Property"), to the United States. On January 10, 2001, third-party petitioner, Cotswold Trading Co. Ltd. ("Cotswold"), filed a petition under 21 U.S.C. § 853(n) claiming a first and prior interest over the government in the 1982 Walworth Property. Before the court are the government's motion to dismiss Cotswold's petition for lack of standing or failure to state a claim, filed pursuant to Federal Rule of Criminal Procedure 32.2(c)(1)(A), and Cotswold's motion for summary judgment, filed pursuant to Federal Rule of Criminal Procedure 32.2(c)(1)(B) and Federal Rule of Civil Procedure 56.

As Cotswold has clearly abandoned any claim that it has an interest in the 1982 Walworth Property based on § 853(n)(6)(A), the court grants that portion of the government's motion to dismiss. That leaves the main dispute between the

parties: whether, under § 853(n)(6)(B), Cotswold was a bona fide purchaser ("BFP") for value of a mortgage Frykholm granted to Cotswold on the 1982 Walworth Property in November 1999, two months before Frykholm was indicted in this case. Subsection (B) requires Cotswold to prove by a preponderance of the evidence that it was a BFP for value and was, at the time it obtained its mortgage interest in the 1982 Walworth Property, "reasonably without cause to believe that the property was subject to forfeiture." 21 U.S.C. § 853(n)(6)(B).

In response to Cotswold's motion for summary judgment on this claim, the government essentially argues questions of fact exist as to whether Cotswold was a BFP of the mortgage because it had knowledge of particular facts concerning its investments with Frykholm that would have put a reasonably prudent person on duty of inquiry, which, if prosecuted with ordinary diligence, would have led to actual notice of Frykholm's fraud and, ultimately, the government's interest in the 1982 Walworth Property. (Although the government cites a Seventh Circuit case applying Indiana law for this proposition, *see United States v. LaRosa,* 765 F.2d 693, 697 (7th Cir. 1985), Wisconsin law, which is the law to be applied in this case, *see United States v. Lee,* 232 F.3d 556, 560 (7th Cir. 2000) (claimant's interest in forfeited property determined in reference to the law of the state in which the property is located), *cert. denied,* 534 U.S. 940, 122 S.Ct. 315, 151 L.Ed.2d 235 (2001), is of like effect. *See New Dells Lumber Co. v. Pfiffner,* 216 Wis. 638, 258 N.W. 375, 378 (Wis. 1935); *Spangler v. Kittel,* 172 Wis. 583, 179 N.W. 758, 761 (Wis. 1920).) Specifically, the government points out the following facts should have acted as "warning flags" to put Cotswold on notice to conduct a further inquiry into Frykholm: (1) the nature and appearance of the investment offerings themselves, which promised 100% returns within a very short period of time (35, 15, and 10 days); (2) Frykholm's failure to pay the profits or return the principal,

despite Cotswold's repeated demands to do so; (3) the operation of Frykholm's businesses, such as the use of mail drop boxes for her business addresses; and, perhaps most significant to the government's theory, (4) letters that Cotswold's attorney, in his attempts to get Frykholm to pay up, sent to Frykholm in which he threatened to report her to "the authorities in both Illinois and Switzerland, as well as any other pertinent jurisdiction" and later threatened to turn her into the U.S. Attorney's Office. Based on these facts, had Cotswold conducted "even a cursory inquiry" into Frykholm's background, says the government, it would have soon discovered, among other things, (1) Frykholm's businesses did not in fact exist; (2) Frykholm had twice been convicted of fraud or theft-related offenses in an Illinois state court; (3) press coverage of those convictions and civil actions arising out of her fraudulent activities; (4) the state of Illinois had formally prohibited Frykholm from selling securities in Illinois; and (5) Frykholm bought the 1982 Walworth Property for a total of $2.28 million, paid in cash, all of which was in fact derived from the proceeds of the scheme to defraud that led to her indictment in this case.

In the court's opinion, however, the government expects too much of what a "cursory inquiry," let alone a reasonably diligent one, would produce. First of all, it is undisputed that Cotswold conducted a title search on the 1982 Walworth Property when it first obtained the mortgage in November 1999 — two months before January 2000, when Frykholm was indicted and the government filed its *lis pendens* notice on the property. That title search indicated a clear title on the property — no liens, encumbrances, or other defects. Although no other mortgages were listed on the title search, the court does not see how Cotswold could have reasonably inferred from this, as the government suggests, that Frykholm paid for the property entirely in cash *and* the cash was derived from her scheme to defraud. Speaking only of what Cotswold could have uncovered from its due diligence into

just the 1982 Walworth Property then, there is simply nothing that would have given Cotswold cause to think the property might be subject to forfeiture by the government.

But, assuming Cotswold truly suspected Frykholm might be criminally responsible for refusing to make good on its investments, as its attorney's letters to her may have indicated (the court of course draws all reasonable inferences in the government's favor, as it is Cotswold's motion for summary judgment), then it is perhaps arguable that Cotswold had a duty to inquire further into not just the 1982 Walworth Property, but into Frykholm's personal background as well. Even so, the court does not see how such a further inquiry, done in a reasonably diligent manner by a private company like Cotswold (as opposed to a full blown criminal investigation by the government), could have uncovered enough information such that Cotswold would have reasonable cause to believe the 1982 Walworth Property was subject to forfeiture — i.e., that Frykholm had specifically purchased the 1982 Walworth Property with the proceeds of her current scheme to defraud. In fact, the government has not introduced any evidence that Cotswold actually knew or reasonably could have learned that Frykholm was defrauding numerous other investors, had been doing so for at least the previous year, and had used their money to buy the 1982 Walworth Property in January 1999 — either on its own or because someone tipped Cotswold off about the FBI investigation going on at the time (November 1999) that eventually led to Frykholm's indictment. While it is certainly true Cotswold may have believed Frykholm was cheating *it,* there is nothing to show it knew she was at the same time engaging in a much more far ranging scheme to defraud *and* had used the proceeds of that scheme to buy the 1982 Walworth Property. Moreover, Frykholm's purchase of that property predated Cotswold's investments with Frykholm, so, even assuming Cotswold suspected Frykholm of defrauding it, Cotswold still would have no reason to believe Frykholm had used

its illegally obtained money to buy the property. In the end, a reasonably diligent background check into Frykholm[1] may have uncovered a somewhat sketchy past that might have given pause to a prudent investor contemplating an investment with her, but — and this is really the heart of the matter — it is simply unrealistic to expect Cotswold to have discovered that the 1982 Walworth Property in particular was bought with the proceeds of Frykholm's scheme to defraud and, therefore, was subject to forfeiture.

For the reasons stated above, the government's motion to dismiss is granted in part and denied in part and Cotswold's motion for summary judgment is granted.

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[1] This means something beyond what Cotswold actually did in this case. Before investing with Frykholm, Cotswold contacted the Better Business Bureau of Rockford. After investing with her, it hired a private detective agency to check into her. Neither of these inquiries revealed anything to alert Cotswold about Frykholm.

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

UNITED STATES OF AMERICA,

Plaintiff-Appellant,

v.

LINDA K. FRYKHOLM,

Defendant.

Intervening Third-Party Claimant:
Cotswold Trading Company, Ltd., *Appellee.*

No. 03-1990

Argued Feb. 27, 2004
Decided March 25, 2004

Rehearing and Rehearing *En Banc* Denied June 7, 2004.

Robert P. Boyer, Jr. (argued), Asset Forfeiture & Money Laundering Sec., Washington, DC, for Plaintiff-Appellant.

James P. Devine, Williams & McCarthy, Jason H. Rock, Barrick, Switzer, Long, Balsley & Van Evera, Rockford, IL, Steven L. Kessler (argued), New York, NY, Robert A. Chapman, Chicago, IL, for Claimant-Appellee.

Before EASTERBROOK, MANION, and EVANS, *Circuit Judges.*

EASTERBROOK, *Circuit Judge.*

Linda Frykholm must have the tongue of an angel, though she has the morals of a fiend. She persuaded people to invest $15 million in a get-rich-quick scheme, even though the promises she made were transparently too good to be true (100% return in a month) and she had no means to back her promises. Her only relevant credential was a 1994 conviction

for theft and forgery, which she did not tout; her "business address" was a mail drop; routine inquiry would have disclosed that the corporations through which she purported to do business did not exist and that Illinois securities officials had entered a stop order against her promotions. Her persuasiveness was augmented, however, by the staple ingredient of any Ponzi scheme: the first generation of investors was handsomely rewarded with money being raised from the next generation, and these ecstatic clients became her avid promoters. Yet collapse was inevitable. The system works only while each new generation of investors puts in at least twice as much as the last, and exponential growth cannot last: after a few doublings there aren't enough suckers left in the whole world. When Frykholm's scam imploded she had net receipts of about $10 million (having taken in $15 million and paid out $5 million), of which prosecutors have been able to locate some $4 million; the rest either was devoted to living the high life or has been hidden someplace from which Frykholm hopes to retrieve it after her release. (We affirmed her sentence, 144 months' imprisonment, in *United States v. Frykholm,* 267 F.3d 604 (7th Cir. 2001).) At least the asset recoveries are enough to return about 30% of the victims' losses.[1] Forfeiture of all assets traceable to the scam's proceeds is part of Frykholm's sentence, and the United States plans to use these assets to make restitution to victims, as 21 U.S.C. § 853(n)(1) permits.

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[1] The figures in the text might lead one to think that the payout would be closer to 40%, but that's not right. Frykholm paid out the $5 million against about $2.5 million in investment. That's why the first wave of investors was so enthusiastic. The unpaid investors chipped in about $12.5 million, and $4 million is available to them. If Cotswold prevails in this litigation, then about $1.8 million will be left to satisfy about $9 million in victims' claims.

Title to all forfeitable assets vests in the United States as soon as criminal proceeds are invested; a judgment of forfeiture just confirms that this has occurred. 21 U.S.C. § 853(c). Third parties who acquire interests in the property between the date of the act allowing forfeiture and the date of the judgment may be taken unawares, and § 853(c) shelters their interests to the extent that "the transferee establishes in a hearing pursuant to subsection (n) that he is a bona fide purchaser for value of such property who at the time of purchase was reasonably without cause to believe that the property was subject to forfeiture under this section."

Cotswold Trading Company, one of Frykholm's victims, made a claim to some of her assets under § 853(c). Cotswold entrusted a total of $1.1 million to Frykholm. The initial investment of $100,000, made in March 1999, was to be doubled and repaid within 35 days. When Frykholm did not keep her promise, Cotswold decided to throw good money after bad. It invested another $1 million in exchange for a promise that Frykholm would deliver $2 million within 13 business days. That money came due in mid-July 1999. Again Frykholm did not pay, though she used several variations on "the check is in the mail". Cotswold then "reinvested" the promised but unpaid $2 million in exchange for Frykholm's promise to pay it $4 million within 15 banking days. That obligation came due in late August 1999. All Frykholm delivered was more promises.

Cotswold's lawyer and its principal owner protested by phone, fax, and letter; they threatened to file suit and report Frykholm to the U.S. Attorney. Frykholm continued making promises, but the wire transfers never materialized and her checks bounced. In November 1999 Frykholm and Cotswold executed a settlement and release. Frykholm gave Cotswold a promissory note for $2.2 million due in 100 days and secured by her interest in real estate on Lake Geneva, Wisconsin. For convenience we call this parcel, at 1982 North Lake Shore

Drive in Delavan, Walworth County, Wisconsin, "the Property." Frykholm had purchased the Property for $2,280,000 in January 1999. She paid with 17 checks written by other victims of the scam, so the Property was unencumbered until Frykholm gave Cotswold a mortgage. In January 2000 Frykholm was indicted, and the United States filed a *lis pendens* against the Property. Frykholm never paid the $2.2 million due on the note, and Cotswold now wants to enforce its security interest.

The Property is among the assets ordered forfeited to the United States as representing proceeds of the crime. Cotswold asserted that its interest is superior under § 853(c) and (n)(6)(B). The latter subsection says that a third party prevails if it "is a bona fide purchaser for value of the right, title, or interest in the property and was at the time of purchase reasonably without cause to believe that the property was subject to forfeiture under this section". Cotswold contends that it is a bona fide purchaser for value under Wisconsin law, having given as "value" either the $1.1 million it invested or the $4 million Frykholm owed. The United States questions whether the holder of a security interest given in exchange for an antecedent debt can be a bona fide purchaser for value but has not pursued the point — sensibly so. See Wis. Stat. § 401.201(44)(b); see also *Swift v. Tyson,* 41 U.S. (16 Pet.) 1, 10 L.Ed. 865 (1842), overruled on other grounds by *Erie R.R. v. Tompkins,* 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938). Its principal response is instead that Cotswold either had "cause to believe that the property was subject to forfeiture" or would have acquired such cause by conducting a reasonable investigation. The district court, however, granted summary judgment to Cotswold, ruling that although it likely knew that Frykholm was perpetrating a fraud, it did not know that the Property represented traceable proceeds of that fraud, and thus did not know that the Property "was subject to forfeiture". 2002 U.S. Dist. LEXIS 22040 (N.D.Ill. Nov. 12, 2002). As a result of the district

court's decision, Cotswold gets 200% of the amount it invested (making a tidy profit from Frykholm's scam), while the other victims' recovery will fall to 15%, as the Property represents about half of Frykholm's traceable assets.

On appeal the United States concentrates its energy on contending that § 853(b)(6)(B) asks, not simply what a purchaser actually knows, but what it could have learned after investigation. It is hard to see in this statute an affirmative duty to inquire, but it may make sense to say that what Cotswold actually knew would have alerted any reasonable person to the possibility that real estate purchased by someone perpetrating a financial fraud, and unencumbered by any debt, represents funds skimmed from the venture. A person who has this much knowledge, and then averts his eyes lest he learn more, has actual knowledge via the ostrich inference often used in criminal prosecutions. See *United States v. Ramsey,* 785 F.2d 184 (7th Cir. 1986). A form of knowledge sufficient to support a conviction beyond a reasonable doubt under a statute requiring proof of scienter is more than sufficient to stave off summary judgment in civil litigation. It is hard to go beyond the ostrich inference in the direction of an investigation requirement; after all, the principal function of the bona-fide-purchaser doctrine is to protect buyers that did *not* investigate, and reading § 853(n)(6)(B) to require investigation as a condition of being an innocent purchaser would all but vitiate the statute's goal of protecting persons who meet state-law definitions of bona fide purchasers for value. See *United States v. Lavin,* 942 F.2d 177, 186 (3d Cir. 1991).

The possibility that Cotswold knew enough to permit an ostrich inference — and thus could be found to have *actual* knowledge that Frykholm bought the Property with the proceeds of her fraudulent scheme — prevents summary judgment in Cotswold's favor. The state of Cotswold's knowledge is the subject of a material dispute. A remand

for trial is unnecessary, however, because the record shows that Cotswold does not satisfy one state-law element of bona-fide-purchaser status.

In November 1999, when Cotswold exchanged its investment for the promissory note and mortgage, Frykholm was insolvent. She owed more than $20 million to the investors (all of whom had been promised a doubling, or in Cotswold's case quadrupling, of their funds) yet had only $4 million in available assets. Her insolvency made the transaction a fraudulent conveyance. Section 548(a)(1)(B) of the Bankruptcy Code (11 U.S.C. § 548(a)(1)(B)) provides a standard definition of a fraudulent conveyance: a transfer in which the debtor "(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and (ii)(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation". That definition (which has a parallel in Wisconsin law, see Wis. Stat. § 242.05) fits this situation exactly. See also *In re Loyal Cheese Co.*, 969 F.2d 515, 518-19 (7th Cir. 1992) (noting the similarity between § 548(a)(1) and Wisconsin law). Frykholm was insolvent in November 1999 and did not receive reasonably equivalent value for the exchange; indeed she received no new value at all. Under the law of Wisconsin, a fraudulent conveyance transfers no rights; it prevents the transferee from achieving the status of a bona fide purchaser for value. See *Pippin v. Boyer,* 146 Wis. 69, 130 N.W. 872 (1911); *Rindskopf v. Myers,* 87 Wis. 80, 57 N.W. 967 (1894).

Neither side paid much attention to the effect of the fraudulent conveyance, likely because both sides are represented by forfeiture specialists and have focused on the language of § 853 and opinions interpreting that statute. Everything would have been clearer had the United States initiated an involuntary bankruptcy proceeding against Frykholm. That not only would have brought to the fore § 548 of the

Bankruptcy Code but also would have provided a superior way to marshal Frykholm's remaining assets and distribute them to her creditors. Although § 853(n)(1) allows the Attorney General to use forfeited assets for restitution, it does not create a comprehensive means of collecting and distributing assets. Bankruptcy would have made it pellucid that Cotswold cannot enjoy any priority over the other victims and cannot reap a profit while Frykholm's other creditors go begging. Moreover, bankruptcy would have enabled the trustee to recoup the sums distributed to the first generation of investors, who received $5 million or so against $2.5 million paid in. Those payments could have been reclaimed under the trustee's avoiding powers and made available to all of the bilked investors. It is too late to pursue the profits that Frykholm distributed to the first wave of investors in order to set up the later waves, but it is not too late to prevent the preferential distribution of any further assets to favored investors. Cotswold must stand in line with the rest.

REVERSED

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago, Illinois 60604

June 7, 2004

Before

Hon. FRANK H. EASTERBROOK, Circuit Judge
Hon. DANIEL A. MANION, Circuit Judge
Hon. TERENCE T. EVANS, Circuit Judge

UNITED STATES OF AMERICA,
Plaintiff-Appellant,

No. 03-1990 **v.**

LINDA K. FRYKHOLM,
Defendant.

Intervening Third-Party Claimant:
COTSWOLD TRADING COMPANY, LTD.
Appellee.

Appeal from the United States District Court for the Northern District of Illinois, Western Division.

No. 00 CR 50001

Philip G. Reinhard, Judge.

Order

Appellee filed a petition for rehearing and rehearing en banc on April 26, 2004. No judge in regular active service has requested a vote on the petition for rehearing en banc, and all of the judges on the panel have voted to deny rehearing. The petition for rehearing is therefore DENIED.

21 U.S.C. § 853. Criminal forfeitures

(a) Property subject to criminal forfeiture

Any person convicted of a violation of this subchapter or subchapter II of this chapter punishable by imprisonment for more than one year shall forfeit to the United States, irrespective of any provision of State law —

(1) any property constituting, or derived from, any proceeds the person obtained, directly or indirectly, as the result of such violation;

(2) any of the person's property used, or intended to be used, in any manner or part, to commit, or to facilitate the commission of, such violation; and

(3) in the case of a person convicted of engaging in a continuing criminal enterprise in violation of section 848 of this title, the person shall forfeit, in addition to any property described in paragraph (1) or (2), any of his interest in, claims against, and property or contractual rights affording a source of control over, the continuing criminal enterprise.

The court, in imposing sentence on such person, shall order, in addition to any other sentence imposed pursuant to this subchapter or subchapter II of this chapter, that the person forfeit to the United States all property described in this subsection. In lieu of a fine otherwise authorized by this part, a defendant who derives profits or other proceeds from an offense may be fined not more than twice the gross profits or other proceeds.

(b) Meaning of term "property"

Property subject to criminal forfeiture under this section includes —

(1) real property, including things growing on, affixed to, and found in land; and

(2) tangible and intangible personal property, including rights, privileges, interests, claims, and securities.

(c) Third party transfers

All right, title, and interest in property described in subsection (a) of this section vests in the United States upon the commission of the act giving rise to forfeiture under this section. Any such property that is subsequently transferred to a person other than the defendant may be the subject of a special verdict of forfeiture and thereafter shall be ordered forfeited to the United States, unless the transferee establishes in a hearing pursuant to subsection (n) of this section that he is a bona fide purchaser for value of such property who at the time of purchase was reasonably without cause to believe that the property was subject to forfeiture under this section.

(d) Rebuttable presumption

There is a rebuttable presumption at trial that any property of a person convicted of a felony under this subchapter or subchapter II of this chapter is subject to forfeiture under this section if the United States establishes by a preponderance of the evidence that —

(1) such property was acquired by such person during the period of the violation of this subchapter or subchapter II of this chapter or within a reasonable time after such period; and

(2) there was no likely source for such property other than the violation of this subchapter or subchapter II of this chapter.

(e) Protective orders

(1) Upon application of the United States, the court may enter a restraining order or injunction, require the execution of a satisfactory performance bond, or take any other action to preserve the availability of property described in subsection (a) of this section for forfeiture under this section —

(A) upon the filing of an indictment or information charging a violation of this subchapter or subchapter II of this chapter for which criminal forfeiture may be ordered under this section and alleging that the property with respect to which the order is sought would, in the event of conviction, be subject to forfeiture under this section; or

(B) prior to the filing of such an indictment or information, if, after notice to persons appearing to have an interest in the property and opportunity for a hearing, the court determines that —

(i) there is a substantial probability that the United States will prevail on the issue of forfeiture and that failure to enter the order will result in the property being destroyed, removed from the jurisdiction of the court, or otherwise made unavailable for forfeiture; and

(ii) the need to preserve the availability of the property through the entry of the requested order outweighs the hardship on any party against whom the order is to be entered:

Provided, however, That an order entered pursuant to subparagraph (B) shall be effective for not more than ninety days, unless extended by the court for good cause shown or unless an indictment or information described in subparagraph (A) has been filed.

(2) A temporary restraining order under this subsection may be entered upon application of the United States without notice or opportunity for a hearing when an information or indictment has not yet been filed with respect to the property, if the United States demonstrates that there is probable cause to believe that the property with respect to which the order is sought would, in the event of conviction, be subject to forfeiture under this section and that provision of notice will jeopardize the availability of the property for forfeiture. Such a temporary order shall expire not more than ten days after the date on which it is entered, unless extended for good cause shown or unless the party against whom it is entered consents to an extension for a longer period. A hearing requested concerning an order entered under this paragraph shall be held at the earliest possible time and prior to the expiration of the temporary order.

(3) The court may receive and consider, at a hearing held pursuant to this subsection, evidence and information that would be inadmissible under the Federal Rules of Evidence.

(4) Order to repatriate and deposit

(A) In general

Pursuant to its authority to enter a pretrial restraining order under this section, the court may order a defendant to repatriate

any property that may be seized and forfeited, and to deposit that property pending trial in the registry of the court, or with the United States Marshals Service or the Secretary of the Treasury, in an interest-bearing account, if appropriate.

(B) Failure to comply

Failure to comply with an order under this subsection, or an order to repatriate property under subsection (p) of this section, shall be punishable as a civil or criminal contempt of court, and may also result in an enhancement of the sentence of the defendant under the obstruction of justice provision of the Federal Sentencing Guidelines.

(f) Warrant of seizure

The Government may request the issuance of a warrant authorizing the seizure of property subject to forfeiture under this section in the same manner as provided for a search warrant. If the court determines that there is probable cause to believe that the property to be seized would, in the event of conviction, be subject to forfeiture and that an order under subsection (e) of this section may not be sufficient to assure the availability of the property for forfeiture, the court shall issue a warrant authorizing the seizure of such property.

(g) Execution

Upon entry of an order of forfeiture under this section, the court shall authorize the Attorney General to seize all property ordered forfeited upon such terms and conditions as the court shall deem proper. Following entry of an order declaring the property forfeited, the

court may, upon application of the United States, enter such appropriate restraining orders or injunctions, require the execution of satisfactory performance bonds, appoint receivers, conservators, appraisers, accountants, or trustees, or take any other action to protect the interest of the United States in the property ordered forfeited. Any income accruing to or derived from property ordered forfeited under this section may be used to offset ordinary and necessary expenses to the property which are required by law, or which are necessary to protect the interests of the United States or third parties.

(h) Disposition of property

Following the seizure of property ordered forfeited under this section, the Attorney General shall direct the disposition of the property by sale or any other commercially feasible means, making due provision for the rights of any innocent persons. Any property right or interest not exercisable by, or transferable for value to, the United States shall expire and shall not revert to the defendant, nor shall the defendant or any person acting in concert with him or on his behalf be eligible to purchase forfeited property at any sale held by the United States. Upon application of a person, other than the defendant or a person acting in concert with him or on his behalf, the court may restrain or stay the sale or disposition of the property pending the conclusion of any appeal of the criminal case giving rise to the forfeiture, if the applicant demonstrates that proceeding with the sale or disposition of the property will result in irreparable injury, harm, or loss to him.

(i) Authority of the Attorney General

With respect to property ordered forfeited under this section, the Attorney General is authorized to —

(1) grant petitions for mitigation or remission of forfeiture, restore forfeited property to victims of a violation of this subchapter, or take any other action to protect the rights of innocent persons which is in the interest of justice and which is not inconsistent with the provisions of this section;

(2) compromise claims arising under this section;

(3) award compensation to persons providing information resulting in a forfeiture under this section;

(4) direct the disposition by the United States, in accordance with the provisions of section 881(e) of this title, of all property ordered forfeited under this section by public sale or any other commercially feasible means, making due provision for the rights of innocent persons; and

(5) take appropriate measures necessary to safeguard and maintain property ordered forfeited under this section pending its disposition.

(j) Applicability of civil forfeiture provisions

Except to the extent that they are inconsistent with the provisions of this section, the provisions of section 881(d) of this title shall apply to a criminal forfeiture under this section.

(k) Bar on intervention

Except as provided in subsection (n) of this section, no party claiming an interest in property subject to forfeiture under this section may —

(1) intervene in a trial or appeal of a criminal case involving the forfeiture of such property under this section; or

(2) commence an action at law or equity against the United States concerning the validity of his alleged interest in the property subsequent to the filing of an indictment or information alleging that the property is subject to forfeiture under this section.

(l) Jurisdiction to enter orders

The district courts of the United States shall have jurisdiction to enter orders as provided in this section without regard to the location of any property which may be subject to forfeiture under this section or which has been ordered forfeited under this section.

(m) Depositions

In order to facilitate the identification and location of property declared forfeited and to facilitate the disposition of petitions for remission or mitigation of forfeiture, after the entry of an order declaring property forfeited to the United States, the court may, upon application of the United States, order that the testimony of any witness relating to the property forfeited be taken by deposition and that any designated book, paper, document, record, recording, or other material not privileged be produced at the same time and place, in the same manner as provided for the taking of depositions under Rule 15 of the Federal Rules of Criminal Procedure.

(n) Third party interests

(1) Following the entry of an order of forfeiture under this section, the United States shall publish notice of the order and of its intent to dispose of the property in such manner as the Attorney General may direct. The Government may also, to the extent practicable, provide direct written notice to any person known to have alleged an interest in

the property that is the subject of the order of forfeiture as a substitute for published notice as to those persons so notified.

(2) Any person, other than the defendant, asserting a legal interest in property which has been ordered forfeited to the United States pursuant to this section may, within thirty days of the final publication of notice or his receipt of notice under paragraph (1), whichever is earlier, petition the court for a hearing to adjudicate the validity of his alleged interest in the property. The hearing shall be held before the court alone, without a jury.

(3) The petition shall be signed by the petitioner under penalty of perjury and shall set forth the nature and extent of the petitioner's right, title, or interest in the property, the time and circumstances of the petitioner's acquisition of the right, title, or interest in the property, any additional facts supporting the petitioner's claim, and the relief sought.

(4) The hearing on the petition shall, to the extent practicable and consistent with the interests of justice, be held within thirty days of the filing of the petition. The court may consolidate the hearing on the petition with a hearing on any other petition filed by a person other than the defendant under this subsection.

(5) At the hearing, the petitioner may testify and present evidence and witnesses on his own behalf, and cross-examine witnesses who appear at the hearing. The United States may present evidence and witnesses in rebuttal and in defense of its claim to the property and cross-examine witnesses who appear at the hearing. In addition to testimony and evidence presented at the hearing, the court shall

consider the relevant portions of the record of the criminal case which resulted in the order of forfeiture.

(6) If, after the hearing, the court determines that the petitioner has established by a preponderance of the evidence that —

(A) the petitioner has a legal right, title, or interest in the property, and such right, title, or interest renders the order of forfeiture invalid in whole or in part because the right, title, or interest was vested in the petitioner rather than the defendant or was superior to any right, title, or interest of the defendant at the time of the commission of the acts which gave rise to the forfeiture of the property under this section; or

(B) the petitioner is a bona fide purchaser for value of the right, title, or interest in the property and was at the time of purchase reasonably without cause to believe that the property was subject to forfeiture under this section;

the court shall amend the order of forfeiture in accordance with its determination.

(7) Following the court's disposition of all petitions filed under this subsection, or if no such petitions are filed following the expiration of the period provided in paragraph (2) for the filing of such petitions, the United States shall have clear title to property that is the subject of the order of forfeiture and may warrant good title to any subsequent purchaser or transferee.

(o) Construction

The provisions of this section shall be liberally construed to effectuate its remedial purposes.

(p) Forfeiture of substitute property

(1) In general

Paragraph (2) of this subsection shall apply, if any property described in subsection (a), as a result of any act or omission of the defendant —

(A) cannot be located upon the exercise of due diligence;

(B) has been transferred or sold to, or deposited with, a third party;

(C) has been placed beyond the jurisdiction of the court;

(D) has been substantially diminished in value; or

(E) has been commingled with other property which cannot be divided without difficulty.

(2) Substitute property

In any case described in any of subparagraphs (A) through (E) of paragraph (1), the court shall order the forfeiture of any other property of the defendant, up to the value of any property described in subparagraphs (A) through (E) of paragraph (1), as applicable.

(3) Return of property to jurisdiction

In the case of property described in paragraph (1)(C), the court may, in addition to any other action authorized by this subsection, order the defendant to return the property to the jurisdiction of the court so that the property may be seized and forfeited.

(q) Restitution for cleanup of clandestine laboratory sites

The court, when sentencing a defendant convicted of an offense under this subchapter or subchapter II of this chapter involving the manufacture of amphetamine or methamphetamine, shall —

(1) order restitution as provided in sections 3612 and 3664 of Title 18;

(2) order the defendant to reimburse the United States, the State or local government concerned, or both the United States and the State or local government concerned for the costs incurred by the United States or the State or local government concerned, as the case may be, for the cleanup associated with the manufacture of amphetamine or methamphetamine by the defendant; and

(3) order restitution to any person injured as a result of the offense as provided in section 3663A of Title 18.